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TAGS: EFIN ECON EINV ETRD ELAB AR
SUBJECT: ARGENTINA ECONOMIC AND FINANCIAL REVIEW, NOVEMBER
19 - DECEMBER 3, 2007

¶1. (U) Provided below is Embassy Buenos Aires' Economic and Financial Review covering the period November 19 - December 3, 2007. The unclassified email version of this report includes tables and charts tracking Argentine economic developments. Contact Econoff Chris Landberg at landbergca@state.gov to be included on the email distribution list. This document is sensitive but unclassified. It should not be disseminated outside of USG channels or in any public forum without the written concurrence of the originator. It should not be posted on the internet.

HIGHLIGHTS

-- GoA bond sales: $500 million to Venezuela; $574 million in local auction and $607 million to Social Security Administration
-- Argentine power company EMDERSA raises just $60 million in local IPO.
-- Central Bank earns $2.3 billion on investments of official reserves
-- GoA imposes export taxes on metals and minerals to boost 2008 primary fiscal surplus.
-- Supreme Court ruling in favor of pensioner sets precedent for other cases and creates potential GoA liability of ARP 8 billion
-- Chamber of Deputies extension of the Economic Emergency Law through December 2008
-- Unemployment continues to fall, but doubts increase about INDEC statistics
-- Commodity exports drive January - October trade surplus

Finance

Argentine bond sales: $500 million to Venezuela, $574 million in local auction, and $607 million to Social Security Administration
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¶2. (SBU) In an effort to fulfill the country's financing needs for 2007 before the new administration takes over December 10, the GoA conducted several recent bond sales, including one to Venezuela. On November 13 (announced to the public November 23), the GoA sold $500 million in

dollar-denominated Boden 2015 bonds to Venezuela. (The Boden 2015 is an Argentine law, 10-year, dollar denominated bullet bond first issued October 3 2005, maturing in 2015, carrying a fixed 7% coupon rate.) The bonds were priced at a reported yield of 10.43%, 27 basis points lower than the last issuance of the same bond to the GoV in August (see Econ/Fin Report sent August 22). So far this year, the GoV has financed the GoA for a total of $1.75 billion (effective value), which represents 35% of the GoA's total bond sales this year. It is unclear whether the GoV will repackage these Boden 2015s with Venezuelan securities as a joint sale of the so-called Bono del Sur (BdS). However, it is irrelevant from the GoA's perspective whether the GoV holds the Argentine bonds or flips them in a BdS sale.

¶3. (SBU) This Boden 2015 sale follows on the GoA's November 14 Bonar X auction for $574 million (see readout in November 19 Econ/Fin Report) and the recent IDB loan disbursement to the GoA of $350 million. The GoA also announced in the November 26 Official Gazette that the Social Security Administration (ANSES) had purchased $542 million (face value, equivalent to $607 million effective value) of dollar-denominated Discount bonds issued under Argentine law. The Discount bonds mature in December 2033 and were originally issued in the GoA debt restructuring in 2005. According to local press reports, the Discounts sold to ANSES were priced at 111.9, with a yield of 8.28%, when that same day, the bond was trading much lower at 98.27, corresponding to a yield of 10.41%. If true, the reports suggest that ANSES "voluntarily" purchased a bond with a yield 212 basis points below the market yield. (Note: The GoA already computes as current income the revenues from individuals who have decided to transfer funds from their private pension plans to the public GA system. See February 2 and November 22 Econ/Fin Reports for background on the pension system

reform that allows these transfers. The reason that the GoA sold the bond to ANSES was to gain access to surplus ANSES funds, derived from workers already paying into the public system.)

Argentine power company EMDERSA raises just $60 million in an IPO

¶4. (SBU) On December 3, Empresa Distribuidora Electrica Regional (EMDERSA -- a power distributor in the northwest of Argentina) raised just $60 million in a local IPO, after calling off its original attempt to raise $200 million both locally and internationally. The company originally launched the opening of 155.6 million ordinary class B shares on November 26 in separate tranches targeting local and international equity markets. The company had anticipated a pricing of ARP 3.70 - 4.40 for ordinary class B shares and $11.75-13.97 for global depository shares. However, the offering only attracted bids for $10 million from international investors and $80 million locally (mainly from private pension funds -- AFJPs). Following this disappointing result, the Company canceled the initiative and rescheduled it for December 3, but only for local investors. The second round was also relatively disappointing, with EMDERSA selling only 55 million shares at a price of only about 3.45 per share, obtaining ARP 190 million ($60 million), or 30% of the target amount.

¶5. (SBU) EMDERSA has indicated it plans to use proceeds from the IPO to cover operating and financing costs and to invest in expansion projects (including 110mw/h thermal plant and a combined cycle plant along in Salta province with Pan American Energy) and acquisitions. Many analysts attributed the market's lack of interest in this transaction to the GoA's continued delays in authorizing electricity tariffs increases. The GoA's refusal to raise tariffs largely frozen since 2002 has undermined the profitably of energy companies -- including EMDERSA -- operating in Argentina. Some analysts also criticized the offer as overpriced compared to

other Latin American companies of the sector. EMDERSA (controlling power distribution in the provinces of Salta, San Luis and La Rioja) is controlled by a unit of JPMorgan, which also managed the IPO along with Merrill Lynch.

Argentine Central Bank earns $2.3 billion on investments of official reserves
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¶6. (SBU) The BCRA announced November 28 that it earned $2.3 billion through October 2007 on the investment of its reserves. This represents a 7.1% annual yield, 200 basis points higher than for the same period last year. According to the BCRA, the positive result was due to three factors: the extension of maturities on its investments, currency diversification (especially into the Euro), and increased value of its gold holdings. According to the BCRA release, its Euro portfolio gained 16% and its gold position gained 26% through end-October. The BCRA does not appear to be pursuing a different reserves management strategy than it has in the past, but the BCRA press release boasts that its adequate reserve management -- maximizing reserves while limiting risks -- left it well-positioned to benefit from the dollar's depreciation and the increasing price of gold. The BCRA's latest official report on November 23 shows reserves at $44.4 billion. Press reports on December 3 announced that official reserves had exceeded $45 billion for the first time.

GoA imposes export taxes on minerals to boost the 2008 primary fiscal surplus
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¶7. (SBU) The GoA abruptly imposed on November 30 a new 10% tax on all exports of minerals. This followed recent increases of agriculture and hydrocarbons export taxes (see Nov 19 Econ/Fin Report). The GoA formally announced the measure December 4. In the context of the strong rally in international mineral prices, the action seeks to retain for the government part of the increased revenue going to the sector. Private analysts expect the tax to raise additional revenues of ARP 800 million (slightly over $250 million). (Note: Copper and gold exports alone are estimated at $2.7 billion in 2007.) This tax is the latest effort of

President Nestor Kirchner's government to increase federal tax revenue and boost the GoA primary fiscal surplus prior to the changeover of government on December 10. According to Ecolatina (a local consultancy), the combined increase in export taxes in agriculture, hydrocarbons, and minerals will raise revenues of approximately $2.8-3.2 billion, or over 1% of GDP -- a significant contribution to President-elect Cristina Fernandez de Kirchner's goal of increasing the GoA's primary fiscal surplus to 4% in 2008 (from the estimated 3 to 3.25% in 2007).

¶8. (SBU) Local press articles state that the measure became effective on November 30 by way of two official letters to the Argentine Customs Service, one from the Secretary of Mining and the other from Secretary of Internal Commerce (Guillermo Moreno). These letters instructed Customs to impose the 10% tax on all minerals exports, effective immediately. There is still some question as to whether this measure is legal, given that it appears to violate (or at least modifies) existing law governing the mining sector. Regulation governing the mining sector is codified in Argentina's "Ley de Inversiones Mineras" (Mining Investment Law), introduced in 1993. This law establishes regulations, incentives, and royalty rates (3% on gross output value, paid to provincial governments) for the mining sector for thirty years (ending 2023). It is still unclear at this time if the companies affected by this new tax will seek legal recourse through Argentine courts.

Economic Policy

Supreme Court ruling in favor of pensioner sets precedent for other cases and creates potential GoA liability of ARP 8 billion
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¶9. (SBU) The Argentine Supreme Court ruled November 26 in favor of a pensioner seeking an adjustment to his pension to make up for the extreme divergence in salary and pension levels since the end of the 2001-2002 financial crisis. In the case filed by pensioner Adolfo Badaro, the Supreme Court agreed that the GoA's net 11% increase in pension benefits from 2002 to 2006 did not reflect the much higher increase in salaries during the time period. The Supreme Court ordered the GoA to compensate Mr. Badaro by increasing his pension by 88.5% (retroactive to 2002), based on the increase in statistical agency INDEC's salary indices. The ruling sets a possible precedent for 1.4 million other public pensioners to claim similar adjustments on their pensions.

¶10. (SBU) Osvaldo Giordano, Director of local think tank IDESA (Institute for the Social Development of Argentina), estimates the ruling could increase the GoA's annual expenditures on pensions by ARP 8 billion (over $2.5 billion). However, another local think tank, RSH Consultores, calculates that if this ruling were applied retroactively to all pensioners in the same situation as the claimant, the GoA would face a liability of about ARP 27 billion (over $8.5 billion) for the period 2002-2007, in addition to the ARP 8 billion per year going forward. The Supreme Court also ruled unconstitutional Article 7 of the Social Security Law, which allows Congress to determine the level of pension increases in the annual budget. Instead, the Supreme Court called on Congress to approve an automatic mechanism for adjusting pensions (this would require a change to current law prohibiting indexation).

Chamber of Deputies approves extension of the Economic Emergency Law
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¶11. (SBU) The Chamber of Deputies voted December 4 to approve a one-year extension of the Economic Emergency Law, due to expire December 31. The Senate was due to vote on the law December 5 to allow the new administration to come into office with this important -- albeit controversial -- tool at its disposal. However, the official majority party was unable to muster a quorum, and postponed the vote until next week. The media reports that the Senate will attempt to pass the measure into law December 12, two days after President Cristina Fernandez de Kirchner assumes office. Congress

first approved the Economic Emergency Law in 2002 following Argentina's economic and financial crisis, and has since extended it on an annual basis. This law allows the executive branch to enact a wide range of economic policies by decree (e.g., debt and utility tariff renegotiations), which otherwise would require Congressional authorization. Even though Argentina's economy is growing rapidly for the fifth consecutive year and unemployment is near 8% (see below item), the GoA argues that the extension of the Emergency Law is necessary to allow the country to defend itself in international lawsuits filed by holdouts from the 2005 debt exchange.

Economic Outlook

Unemployment continues to fall, but doubts increase about INDEC statistics
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¶12. (SBU) INDEC (GoA statistical agency) announced November 22 that Argentina's unemployment rate had fallen 0.4 percentage points to 8.1% in the third quarter of 2007, compared to 8.5% in the previous quarter. However, INDEC's report highlighted that it was unable to conduct the

household survey used to calculate the unemployment level in many of the cities where it is normally done, including the key districts of Buenos Aires' suburbs, La Plata, Mar del Plata and Bahia Blanca (representing 63% of the country's population). Instead, the agency calculated the overall unemployment rate assuming that cities not surveyed had unemployment rates roughly equivalent to the level of those surveyed. Local analysts argue that this assumption has biased the index in favor of a lower unemployment rate, since the excluded districts mentioned above are thought to have significantly higher unemployment than the national average.

¶13. (SBU) INDEC is widely accused of tampering with national statistics, principally the CPI index (see Econ/Fin Reports from Feb 2, Sep 20, Oct 26, Nov 19). This latest announcement is the latest INDEC action that is fueling suspicions that INDEC may be manipulating other statistics besides inflation numbers, possibly including (in addition to unemployment) GDP, industrial production, and poverty levels. (Note: INDEC includes beneficiaries of the GoA's "Heads of Households" financial support program as employed in calculating the 8.1% unemployment rate recently announced. When excluding these beneficiaries, the unemployment rate fell to 8.8% in Q3, from 9.5% in Q2.)

Trade

Commodity exports drive January - October trade surplus

¶14. (SBU) Argentina's trade surplus for January - October 2007 totaled $8.3 billion (compared to a surplus of almost $10 billion for the same period in 2006). On a 12-month rolling basis, the trade balance widened to $10.7 billion in October, from $10.5 billion in September. Exports for January-October 2007 increased 18% y-o-y to $44.8 billion, and imports grew 30% y-o-y to $36.5 billion during the same period. Exports in the month of October were higher than expected, growing 32% y-o-y to a historical, single-month record of $5.5 billion, while imports grew 35% y-o-y to $4.4 billion.

¶15. (SBU) October export growth was due to similar increases in both volumes (16%) and prices (14%). Three items explain almost three-quarters of monthly export growth: oilseeds, vegetable oils, and pellets. Overall exports of agribusiness products increased 40% y-o-y in October, while industrial exports rose only 24%, although local speculation is that during October commodity exporters were accelerating shipments ahead of the expected increases in export taxes (reported in the November 19 Econ/Fin Report). Even so, the wide disparity in export growth rates indicates what many analysts see as a marked shift to primary goods and agribusiness products as the main drivers of export growth, taking the lead away from industrial goods exports. In fact,

the accumulated annual trade surplus is mostly the result of the trade in primary goods, which shows a surplus of about $11.5 billion. On the other hand, industry as a whole (including the food industry) experienced a trade deficit -- for the first time in the past decade -- of roughly $3.2 billion.

¶16. (SBU) Exports of fuels and energy were down 5% y-o-y, despite the 29% increase in prices so far in 2007. Volumes of fuel exports fell 27%. Banco Santander calculates that Argentina's external sales of petroleum amounted to 2.16 million barrels in October, or 56% lower than in October 2006.

¶17. (SBU) October import growth was due primarily to volume increases (25%) and much lower price increases (8%). The strength of imports appears to reflect strong domestic demand growth, particularly for energy (even though October is not a peak month for energy consumption). Imports of consumer

goods were up 51% y-o-y, while imports of capital and intermediate goods rose 27% and 42% y-o-y, respectively. Meanwhile, energy-related imports (diesel, carbon, electricity) increased 65% y-o-y in October.

¶18. (SBU) The BCRA's consensus forecast for the 2007 trade surplus is about $9.6 billion, and predicts a decline to $8.4 billion in 2008, with a deceleration in the growth rate for both exports and imports as both global and Argentine growth slow. No further increases in agricultural commodity prices are anticipated, but given their steep acceleration since late Q2, even flat commodity prices would improve the terms of trade by 5% next year. Real import growth is seen decelerating slightly, with a more marked slowdown expected for prices (assuming fuel price pressures abate in 2008).
KELLY